Supreme Court, U.S.

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No. _____

In The

Supreme Court of the United States

DOUGLAS R. WILLOUGHBY, SUZANNE M. HILL, NATHAN J. MARCIANO, and BARBARA C. JORDAN,

Petitioners,

v.

UNITED STATES OF AMERICA

Respondent.

On Petition For A Writ of Certiorari
To The United States Court of Appeals
For The Federal Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

I.R.C. § 3121(a) defines the term "wages" to mean "remuneration for employment." I.R.C. § 104(a)(2) provides that gross income does not include "damages received ... on account of personal injuries...." IBM Corporation, the former employer of petitioners, made payments to them, not to remunerate them for services, but primarily to prevent them from asserting their potential personal injury claims against IBM. The court below determined that an additional purpose for the payments was to encourage petitioners to leave their employment with IBM. The *amount* of the payment made to each petitioner was calculated under a formula based on salary and length of service. The questions presented are:

1. When an employer makes a payment to an employee to prevent the employee from asserting personal injury claims against the employer and/or to induce the employee to leave employment--and not to remunerate the employee for services--does the fact that the *amount* of the payment is calculated using a formula based on salary and length of service transform the payment into "wages" within the meaning of I.R.C. § 3121(a)?

2. When a payor makes a payment to an individual to prevent the individual from asserting potential personal injury claims against the payor, and the individual has bona fide personal injury claims that could have been asserted, must the *amount* of the payment reflect the individual's particular injuries in order for the payment to be considered "received on account of personal injuries," within the meaning of I.R.C. § 104(a)(2)?

LIST OF PARTIES

This action originated in the United States Court of Claims as a consolidated action by 2,639 named individual plaintiffs (including individuals added to the action as plaintiffs after the action was initially filed).[1] Of these 2,639 plaintiffs, four individuals (the four petitioners named in the caption hereof) were selected as test cases, and the action was suspended as to the other 2,635 plaintiffs. On appeal to the Federal Circuit Court of Appeals, the four named test-case plaintiffs were identified as plaintiffs-appellants, and the 2,635 plaintiffs as to whom the action was suspended by the trial court were identified (by naming the first of those plaintiffs when listed alphabetically) as plaintiffs only. Accordingly, only the four individuals named in the caption hereof are petitioners in this action. The United States of America is the only defendant in this action.

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[1] For purposes of these computations, a husband and wife whose claims are based on a jointly filed federal income tax return are counted as one individual.

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PETITION FOR A WRIT OF CERTIORARI

Petitioners hereby petition this Court for a writ of certiorari to review the judgment and opinion of the Court of Appeals for the Federal Circuit.

OPINIONS BELOW

The opinion of the court of appeals (App. A at 1a-10a) is reported at 228 F.3d 1360 (Fed. Cir. 2000). The decision of the lower court from which the appeal is taken (App. B at 11a-42a) is reported at 44 Fed. Cl. 260 (1999).

JURISDICTION

A final decision was entered by the court of appeals below on September 28, 2000. App. 1a. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS INVOLVED

The relevant portions of I.R.C. §§ 104, 3101, and 3121 are set forth in the Appendix, *infra*, at App. 43a-45a.

STATEMENT OF THE CASE

Petitioners are former employees of International Business Machines Corporation ("IBM") who left their

employment with IBM between 1991 and 1994 during IBM's workforce reduction (hereinafter, "downsizing"). Each of the petitioners received a payment from IBM (a "Payment") in exchange for signing a General Release and Covenant Not To Sue. IBM reported the Payments on IRS Form W-2 and withheld income and employment ("FICA") taxes from the Payments pursuant to I.R.C. §§ 3402 and 3102, respectively. Petitioners filed U.S. Individual Income Tax Returns reporting the Payments as taxable income. Petitioners subsequently filed claims for refund of both the income taxes and FICA taxes withheld from, or otherwise paid with respect to, the Payments. The IRS disallowed the refund claims, and petitioners instituted refund litigation in the Court of Federal Claims (hereinafter, the "trial court") as part of a consolidated action involving 2,639 plaintiffs. The trial court adopted a procedure under which four of the plaintiffs were designated as test-case plaintiffs (petitioners herein) and the proceedings were suspended as to the remaining plaintiffs. App. 12a.

In support of their income tax refund claims, petitioners argued that their Payments were excludable from gross income under I.R.C. § 104(a)(2) because IBM's principal purpose for making the Payments to them was to prevent them from asserting their bona fide potential personal injury claims.[2] In support of their FICA tax

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[2] The term "personal injury claims" is used herein to mean tort claims based on personal injuries. For purposes of applying I.R.C. § 104(a)(2) to payments received before August 21, 1996 (including the Payments at issue in this case), the term "personal injuries" includes "nonphysical injuries to the individual, such as those affecting emotions, reputation, or character" as well as "'personal embarrassment,' 'mental strain,' and injury to 'personal reputation.'" *United States v. Burke*, 504 U.S. 229, 236-37 n.6 (1992). Section 1605(a) of the Small Business Job Protection

refund claims, petitioners argued that their Payments were not subject to FICA taxes under I.R.C. § 3101(a) because the Payments were not made to them as "remuneration for employment" within the meaning of I.R.C. § 3121(a).

On cross-motions for summary judgment in the trial court, petitioners presented evidence showing that IBM, motivated by its desire to prevent its downsized employees, including petitioners, from asserting their potential personal injury claims, made Payments to those of its downsized employees, including petitioners, who agreed to release their potential claims as of the time they left their employment. Petitioners also presented evidence showing that IBM faced a significant risk of personal injury claims from the downsized employees, including petitioners, all of whom suffered varying degrees of reputational and emotional injury as a result of actions taken by IBM during the downsizing, and all of whom had bona fide personal injury claims that they could have asserted against IBM in the absence of releases. IBM testified that it did not make the Payments to remunerate any of its downsized employees for services, and there is no contrary evidence in the record.

Respondent disputed the fact that IBM's principal purpose for making the Payments was to prevent departing employees from asserting personal injury claims against IBM, proffering evidence showing that IBM implemented the downsizing programs to induce employees to leave their employment and that the

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Act of 1996, Pub. L. 104-188, amended section 104(a)(2) to apply only to damages received on account of personal *physical* injuries or sickness. The amendment generally applies to all payments received after August 20, 1996.

Payments shared certain characteristics with severance payments that are not intended to settle potential claims.

The parties agreed that the amount of each Payment was determined under a formula based on the recipient's salary and years of service. The four petitioners stipulated that, as of the time they received their Payments, they, personally, had not experienced any symptoms of physical or emotional harm and had not communicated with IBM regarding their personal injuries or potential personal injury claims.

The trial court made no finding as to whether IBM's principal purpose for making the Payments to petitioners was to prevent them from asserting their potential tort claims. Instead, the court ruled that the Payments could not be considered settlements of personal injury claims and could not be treated as made on account of personal injuries, as required by I.R.C. § 104(a)(2), because (1) the Payments and releases were not individually tailored to petitioners' particular claims and injuries and (2) the amount of each Payment was based on the recipient's salary and years of service. App. 30a-34a. The court further ruled that the Payments were necessarily "wages" within the meaning of I.R.C. § 3121(a), regardless of IBM's purpose for making them, because the Payments were made by an employer to its employees and the amounts of the Payments were based on salary and years of service. App. 37a-41a.

On appeal, the Federal Circuit Court of Appeals, in an opinion by Judge Rader, affirmed both of the trial court's rulings. The court of appeals, like the trial court, made no finding as to IBM's principal purpose for making the Payments. Instead, the court of appeals first held that the

Payments were not made "on account of personal injuries" because the amounts of the Payments did not reflect the recipients' individualized injuries. App. 6a. Second, the court of appeals held that the Payments were "wages" because the amounts of the Payments were based on salary and years of service and because the four individual petitioners had not communicated with IBM regarding their claims and injuries before receiving their Payments. App. 9a-10a.

Petitioners have filed this petition for a writ of certiorari in order to seek review of those holdings.

A. IBM's Downsizing

In the late 1980s, IBM began to reduce the size of its workforce through a series of "downsizing" programs. IBM placed responsibility for workforce reduction on line managers, but the line managers were given little authority to terminate employees involuntarily because IBM desired to reduce the workforce through "voluntary" programs. Consequently, line managers used psychological pressure to encourage employees to resign or retire.

In 1991, IBM introduced new measures to persuade large numbers of employees to leave. These new measures included several employment practices that were intended to identify the employees who made the smallest relative contributions to its business. First, IBM announced that it was "raising the bar" when judging employee contributions. Second, IBM announced that, in the employee performance appraisal process, it would emphasize certain criteria that employees felt were highly subjective and subject to manipulation. Third, IBM

adopted a company-wide "ranking" system, which IBM described as "a comparison of employees . . . to determine their relative contribution."

The changes to the performance appraisal system caused many employees to question the fairness and validity of their appraisals. Some employees experienced unexpected reductions in the rating of their job performance with little or no explanation. Moreover, few employees believed their rankings and performance ratings were confidential.

Some managers used the ranking process to pressure targeted employees into resigning or retiring. Some managers allowed nonessential employees to transfer into their departments with a view to using the ranking and appraisal process to induce those employees to leave IBM so that the managers could meet their workforce reduction targets. Some transferred employees were low-ranked in their new positions and then, with little chance to adapt, were told they were at risk of being terminated involuntarily.

During the early 1990s, IBM executives stated publicly that IBM was using the downsizing process to weed out deadwood and underperformers. It was widely known that IBM executives made those statements. Those statements created the false impression that any employee leaving IBM under the downsizing programs was likely to be an underperformer. That false impression was exacerbated by the fact that many employees were encouraged to leave IBM through the use of low rankings and performance appraisals.

The reputations of employees leaving IBM under the downsizing programs were damaged by IBM's statements. Many employers would not hire "downsized" IBM employees because IBM's public statements caused them to believe those employees were poor performers.

Each of the four petitioners testified that he or she suffered (1) reputational injuries as a result of public statements by IBM executives that IBM was using the downsizing process to weed out deadwood and underperformers and (2) additional reputational and emotional injuries as a result of events specific to him or her. Each of the four petitioners also stipulated that, as of the time he or she received a Payment, he or she had not experienced "symptoms" of physical or emotional harm.

B. IBM's Concern About Potential Personal Injury Claims

IBM's Fed. R. Civ. P. 30(b)(6) witness testified that IBM knew its employees would and did suffer emotional and reputational injuries as a result of the downsizing and that the employees complained to IBM management about their treatment. He testified specifically that: (1) IBM knew its employees would be emotionally and psychologically harmed by the impending downsizing; (2) IBM was concerned that many employees might complain about the ways in which managers sought to achieve workforce reduction targets; (3) IBM knew that employees believed the ranking process resulted in highly arbitrary evaluations of their contributions; (4) IBM knew that some employees believed IBM was trying to induce them to leave voluntarily by telling them they were underperformers whether or not it was true; (5) IBM knew that some employees felt that, as part of the downsizing

process, they were subjected to overwork, assignment to unfamiliar positions, and unrealistic performance plans; (6) IBM knew that some employees who had been redeployed were low-ranked in their new positions and then, with little chance to adapt, were told they were at risk of being involuntarily terminated; (7) IBM knew that some employees who were encouraged to leave for performance-based reasons would not view themselves as underperformers or lesser contributors; and (8) as downsizing progressed, IBM knew that some employees were suffering emotionally and were hurt by the downsizing.

IBM's witness also testified that IBM was concerned about the risk of widespread tort-based litigation. He testified that IBM knew that, in the absence of releases from the large numbers of departing employees: (1) the departing employees might assert claims alleging that the ranking and appraisal systems, and other managerial actions, injured their reputations and/or were being intentionally used to undermine their sense of self-worth; (2) those employees who had been redeployed and then had received low rankings or appraisals might assert claims alleging that IBM had made deliberate misrepresentations to lure them into positions in which they were likely to underperform or would be easy targets for criticism and pressure to resign; (3) the departing employees might assert claims for emotional and reputational injuries; and (4) the departing employees represented a threat of litigation that IBM wished to avoid. He also testified that IBM considered every departing employee to be a litigation threat.

IBM's witness testified that IBM knew about the employees' injuries, complaints, and potential claims

because (1) the employees complained to management through mechanisms that IBM maintained to obtain information from employees, and (2) IBM was subject to employment-related lawsuits.

The four petitioners in this action were not among the employees who complained to management about their injuries and potential claims.

C. IBM's Reasons for Making the Payments to Petitioners

The parties to this action have stipulated that the Payment received by each petitioner was made "in exchange for signing" a release.

IBM's witness testified that IBM made the Payments to avoid litigation risks. He testified that: (1) the Payments were used by IBM as part of an approach that was designed to ensure that IBM's departing employees would not sue IBM after they left; (2) IBM intended the Payments to settle potential personal injury claims; (3) IBM made payments only to departing employees who signed releases because IBM considered every departing employee to be a litigation threat; (4) the Payments were not made gratuitously; (5) the Payments were not intended to be a substitute for income the employees would lose by leaving their employment; and (6) the Payments were not made for the purpose of remunerating or rewarding departing employees for services.

IBM's witness also testified that IBM made the Payments to induce employees to leave the company under programs that included releases of claims.

D. Structure of the Payments

A Payment was made to every employee who, between 1991 and 1994, departed IBM under a downsizing program and signed a release. The amount of each Payment was determined under a formula based on the recipient's salary and years of service. An employee who revoked the release after leaving the company and receiving a Payment was required to return the Payment but was not permitted to return to work. An employee who was rehired shortly after leaving the company and receiving a Payment was required to return a portion of the Payment.

E. The Proceedings Below

Throughout the proceedings in the trial court and on appeal, petitioners made the following arguments: (1) the Payments were excludable from income under I.R.C. § 104(a)(2) because petitioners had bona fide personal injury claims that they could have asserted against IBM and IBM's principal purpose for making the Payments to petitioners was to prevent petitioners from asserting any personal injury claims they might have; and (2) even if the court were to determine that IBM's principal purpose for making the Payments was to induce petitioners to leave employment, or that the Payments were not excludable from income under I.R.C. § 104(a)(2) for some other reason, the Payments still were not "wages" subject to FICA taxes because they were not made as "remuneration for employment" within the meaning of I.R.C. § 3121(a).

Jurisdiction in this case was conferred upon the trial court pursuant to 28 U.S.C. § 1491(a). The trial court granted respondent's cross-motion for summary judgment

and denied petitioners' cross-motion for summary judgment. The court of appeals affirmed the judgment of the trial court.

With respect to the income tax issue arising under I.R.C. § 104(a)(2), the trial court stated that petitioners "arguably have shown that IBM's decision to require 'releases' stemmed from its concern over potential tort claims" (App. 30a) but held that petitioners did not satisfy two requirements of I.R.C. § 104(a)(2) that were described by this Court in *Commissioner v. Schleier*, 515 U.S. 323, 337 (1995). Those requirements are: "First, the taxpayer must demonstrate that the underlying cause of action giving rise to the recovery is 'based upon tort or tort type rights; and second, the taxpayer must show that the damages were received 'on account of personal injuries or sickness.'" *Schleier, supra*, 515 U.S. at 337 (quoted by the trial court at App. 26a).

The trial court did not determine that IBM made the Payments to petitioners for a purpose other than avoiding their potential tort claims. Instead, the court held that the Payments did not satisfy the first *Schleier* requirement because petitioners had "not shown that the payments they received were based on any one individual's tort or tort-type claims." App. 31a.

The trial court also held that the Payments did not satisfy the second *Schleier* requirement because (1) there was no evidence that "the payment or release was individually tailored to reflect [petitioners'] individual injuries," and (2) the formula under which the amount of the Payments was determined "was not influenced by potential tort claims." App. 34a.

With respect to the FICA tax issue arising under I.R.C. § 3121(a), the trial court did not determine that IBM made the Payments to petitioners to remunerate them for employment or for services. Instead, the trial court construed this Court's decision in *Social Security Board v. Nierotko*, 327 U.S. 358 (1946), to mean that "all payments arising from the employer-employee relationship" are subject to FICA taxes unless they are expressly excluded by the twenty-one exceptions listed in I.R.C. § 3121(a). App. 37a-38a. The trial court concluded:

> [T]he fact that plaintiffs were required to give up certain claims to obtain the program payments does not change the wage-like or severance-like character of the payments. Whether these payments are settlement payments or were paid to entice employees to leave is not determinative because the payments at issue clearly were derived from a severance-type formula based on the employee-employer relationship.

App. 41a.

The court of appeals affirmed the trial court's holding that I.R.C. § 104(a)(2) did not apply to the Payments because the Payments did not satisfy the second *Schleier* requirement. The court of appeals reasoned:

> Even assuming that the employees suffered some personal injury before entering the payment agreements, no evidence of record suggests that any part of the payments was attributable to those individualized injuries. As found by the trial court, the payments were calculated based on each employee's salary and years of service with

> IBM. . . . Thus, as in *Schleier*, the amount of payment was "completely independent of the existence or extent of any personal injury." [Citation to *Schleier* omitted]

App. 6a.

The court of appeals expressed no opinion regarding the trial court's holding that the Payments failed the first *Schleier* requirement.

The court of appeals also affirmed the trial court's determination that the Payments were "wages" for FICA purposes. The court of appeals acknowledged that "the payments at issue were at least partially motivated by IBM's desire to settle any claims departing employees may have had against it." App. 9a. Moreover, the court of appeals left open the possibility that this was the principal purpose for the Payments—the court made no finding regarding IBM's principal purpose. Nonetheless, the court of appeals held that if the *amount* of a payment to an employee is based on salary and years of service, the payment constitutes "wages" unless the payment is "closely related" to some specific claim of the employee against the employer. Because the four petitioners stipulated that they had not communicated with IBM regarding their injuries or claims, the court of appeals determined that the Payments they received were not "closely related" to any claims they had. App. 9a-10a.

The court of appeals did not address petitioners' argument that a payment to induce an employee to leave employment is not "remuneration for employment," within the meaning of I.R.C. § 3121(a), and therefore not "wages."

REASONS FOR GRANTING THE WRIT

A. The Court of Appeals' FICA Ruling Is Inconsistent With the Plain Language of I.R.C. § 3121(a), Misapplies This Court's Decision in *Social Security Board v. Nierotko*, 327 U.S. 358 (1946), Is Inconsistent With Prior Circuit Court Decisions That Correctly Restrict FICA Taxes to Compensatory Payments, and Will Affect Corporate Downsizing Programs Throughout the United States.

The court of appeals' decision imposes FICA taxes on noncompensatory payments, ignoring the plain language of the applicable statutory provisions and a well-developed body of case law holding that a payment to an employee is "wages" for FICA and income tax withholding purposes only if it is made to compensate the employee for the employee's service.[3] The court of appeals' decision is based on an erroneous interpretation of this Court's decision in *Social Security Board v. Nierotko*, 327 U.S. 358 (1946).

I.R.C. § 3101(a) imposes FICA taxes on "wages ... received ... with respect to employment." I.R.C.

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[3] The definition of "wages" for income tax withholding purposes, set forth in I.R.C. § 3401(a), is essentially identical to the FICA definition. I.R.C. § 3401(a) defines "wages" to mean "all remuneration ... for services performed by an employee for his employer...." Although the specific exceptions provided by I.R.C. § 3121(a) and I.R.C. § 3401(a) differ, and the penultimate sentence of I.R.C. § 3121(a) permits the IRS to adopt administrative exceptions under I.R.C. § 3401(a) without having them apply automatically to I.R.C. § 3121(a) as well, the basic definition in both provisions equates "wages" with "remuneration for services." In *Rowan Companies, Inc. v. United States*, 452 U.S. 247, 249 (1981), this Court described the basic definitions of "wages" in I.R.C. § 3121(a) and I.R.C. § 3401(a) as "substantially identical."

§ 3121(a) states that, for FICA purposes, "wages" means "remuneration for employment." I.R.C. § 3121(b) states that, for purposes of I.R.C. § 3121(a), "employment" means "any service, of whatever nature, performed . . . by an employee for the person employing him . . . ." Read together, these provisions limit the FICA tax base to "wages," meaning "remuneration for any service, of whatever nature, performed . . . by an employee for the person employing him."

Under the plain language of these provisions, in order for a payment to an employee to be subject to FICA taxes, the payment must be made to "remunerate," or compensate, the employee for "service."[4] A payment that is made to an employee for a noncompensatory purpose cannot be "wages" subject to FICA taxes under the plain language of the statute.

In *Social Security Board v. Nierotko*, 327 U.S. 358 (1946), this Court held that the term "wages," as used in the computation of Social Security benefits (*see* 42 U.S.C. § 409), included back pay awarded to an employee under the National Labor Relations Act ("NLRA") to a wrongfully discharged employee, even though the employee did not actually perform any service during the period for which he received the award.

The *Nierotko* Court analyzed three distinct terms in the definition of "wages" in the Social Security Act, which is essentially identical to the definition in I.R.C. § 3121. First,

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[4] The *American Heritage Dictionary* (Second College Edition, 1991) gives the following definition for "remunerate": "1. to pay to (a person) for goods provided, services rendered, or losses incurred. 2. To compensate for; make payment for: *remunerate his efforts.*"

the Court determined that the award under the NLRA was "remuneration," reasoning that the award was intended to be a substitute for wages lost as a result of the employer's wrongdoing. 327 U.S. at 364-65. Second, the Court determined that the terminated employee had "employment," reasoning that the NLRA treated the employee as continuing to be an employee despite the discharge. 327 U.S. at 365. Third, the Court determined that the term "service," as used in the Social Security Act definition, was not limited to productive work but included "the entire employer-employee relationship for which compensation is paid to the employee by the employer." 327 U.S. at 365-66.

Following the *Nierotko* decision, some courts have held that back pay and front pay awarded to a wrongfully discharged employee are "wages" for tax purposes. *See, e.g., Gerbec v. United States,* 164 F.3d 1015 (6th Cir. 1999) (damages awarded under ERISA § 502(a)(3) in lieu of lost earnings are "wages" for FICA purposes); *Mayberry v. United States,* 151 F.3d 855 (8th Cir. 1998) (same); *Hemelt v. United States,* 122 F.3d 204 (4th Cir. 1997) (same); *Ainsworth v. United States,* 399 F.2d 176 (Ct. Cl. 1968) (back pay awarded under the federal Back Pay Act of 1956 is "wages" for FICA purposes).

In *Gerbec,* the Sixth Circuit reasoned: "The holding in *Nierotko* clearly supports the conclusion that awards representing a loss in wages, both back wages and future wages, that otherwise would have been paid, reflect compensation paid to the employee because of the employer-employee relationship, regardless of whether

the employee actually worked during the time period in question." 164 F.3d at 1026.[5]

At the same time, post-*Nierotko* decisions have uniformly and correctly held that payments to an employee for noncompensatory reasons are not "wages" for FICA or income tax withholding purposes.

In *Allstate Insurance Co.. v. United States*, 530 F.2d 378 (Ct. Cl. 1976); *Humble Oil & Refining Co. v. United States*, 442 F. 2d 1362 (Ct. Cl. 1971); and *Humble Pipe Line Co. v. United States*, 442 F. 2d 1353 (Ct. Cl. 1971), the Court of Claims (the predecessor of the Federal Circuit Court of Appeals[6]) held that employer reimbursements of employee moving expenses were not "wages" because the reason for the reimbursement was to induce the employees to move. In *Humble Oil*, the Court of Claims explained that the payments "were not meant by Humble to be in any sense compensation 'for services performed.'" 442 F.2d at 1367.

In *Hotel Conquistador, Inc. v. United States*, 597 F.2d 1348, 1350 (Ct. Cl. 1979), *cert. denied*, 44 U.S. 1032 (1980), the Court of Claims held that the value of meals made available to hotel employees for the purpose of

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[5] The Fifth Circuit has rejected the reasoning adopted by the Sixth, Eighth, and Fourth Circuits in *Gerbec, Mayberry,* and *Hemelt*, respectively. In *Dotson v. United States*, 87 F.3d 682, 689-9 (5th Cir. 1996), the Fifth Circuit held that a payment to settle a claim for loss of earning capacity under ERISA § 502(a)(3) was not "wages," reasoning: "The [payment] compensated for the 'loss in earning capacity,' not for services already performed, and is thus not subject to wage taxation."

[6] All decisions of the Court of Claims entered before September 30, 1982, have been adopted as binding precedent by the Federal Circuit Court of Appeals. *See South Corp. v. United States*, 690 F.2d 1368, 1379 (Fed. Cir. 1982).

minimizing the amount of time the employees would need for meals during working hours was "not 'remuneration' and, therefore, not 'wages.'"

In *Stubbs, Overbeck & Associates, Inc. v. United States*, 445 F.2d 1142 (5th Cir. 1971), the Fifth Circuit held that *per diem* payments paid as living allowances to employees at a remote worksite "were not made as compensation for services performed and, consequently, were not 'wages' within the meaning of section 3401(a)." *Id.* at 1150. The Fifth Circuit explained: "It should be noted that Section 3401(a) does not provide that *all* payments made to an employee are wages. In order to be wages, the payments must be made 'for services performed.' . . . An employee may receive economic benefits from his employer that are not subject to the withholding provisions of the Code." 445 F.2d at 1149.

In *Central Illinois Public Service Co. v. United States*, 435 U.S. 21, 30-31 (1978), this Court cited *Humble Pipeline*, *Humble Oil*, and *Stubbs, Overbeck* with approval. In *Central Illinois*, this Court flatly rejected as "facile" the United States' argument that every payment by an employer to an employee constitutes "wages" for tax purposes if it is "a result of the employment relationship and [is] a part of the total of the personal benefits that arose out of the relationship." 435 U.S. at 29.

Here, there has been no factual finding that IBM made the Payments to remunerate petitioners for services, however broadly the term "services" is defined. To the contrary, the court of appeals below stated: "[T]he record reveals that the payments were intended both to induce employees to leave and to settle any claims the employees

may have had against IBM."[7] App. 8a. *Neither* of those purposes is a purpose to "remunerate" employees for services or employment, whether based on the dictionary definition of "remunerate,"[8] or based on this Court's explanation of the term in *Nierotko*.

Indeed, in *Lockheed Corporation v. Spink*, 517 U.S. 882, 895 n.7 (1996), a case involving the prohibited transaction rules in ERISA, Justice Thomas pointed out that benefits paid "as part of an early retirement plan [do] not compensate the employee so much for services rendered as for the distinct act of leaving the company sooner than planned."[9] There is no authority equating an inducement to leave employment with "remuneration for services."[10]

IBM's witness expressly testified in this case that the Payments were *not* made for the purpose of remunerating or rewarding departing employees for services and were

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[7] The court of appeals did not determine which of those purposes was the principal purpose for the Payments.

[8] *See* note 4 *supra*.

[9] *See also Waterman v. Commissioner*, 179 F.3d 123, 127 (4th Cir. 1999), *aff'g* 110 T.C. 103 (1998) ("Because *the separation payment was not compensation for Waterman's service but an inducement to leave Navy service*, the Court holds that Waterman was not entitled to the exclusion for combat zone service [under I.R.C. § 112].") (emphasis added).

[10] The Federal Circuit recently held that payments to employees under a voluntary "early out" plan were "wages" where the record showed that the payments were made to reward employees "for hard work and faithful service" and "were designed to replace wages." *Associated Electric Cooperative, Inc. v. United States*, 226 F.3d 1322, 1327 (Fed. Cir. 2000). *Associated Electric* does not state that a payment to induce an employee to leave employment is "wages" if the payment is not intended to reward departing employees for past services.

not intended to be a substitute for income the departing employees would lose by leaving their employment.

Indeed, the *only* fact in the record that suggests *any* relationship between the Payments and petitioners' service is the formula under which the *amount* of each Payment was computed. Nothing in the record, however, links that formula with a compensatory intent. To the contrary, IBM's witness testified only that the formula was used because it was familiar to the employees, as it was used in computing severance payments, and because would seem fair to them. Moreover, the record is replete with evidence establishing a noncompensatory purpose for the Payments.[11]

In the absence of a proper finding that the Payments were made for the purpose of remunerating petitioners for service, and *no such finding has been made or could be made on the record in this case*, the holding of the court of appeals cannot be squared with the plain language of I.R.C. § 3121(a) or with the well-developed case law construing the term "wages" for tax purposes. Surely, the fact that a formula was used to calculate the amount of the Payments cannot transform them from noncompensatory payments into taxable compensatory payments.

The court of appeals' decision, if allowed to stand, will adversely affect the many thousands of United States

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[11] Some circuit court decisions have emphasized payment formulas in determining that the payments in issue therein were wages. *See, e.g., Local 141 Fund v. United States*, 64 F.3d 245 (6th Cir. 1995); *Lane Processing Trust v. United States*, 25 F.3d 662 (8th Cir. 1994). In every one of those cases, however, there was no evidence of a noncompensatory purpose for the payments.

workers who accept payments from their employers as inducements to leave their jobs through "downsizing" programs, as well as their employers.[12]

The Court should grant a writ of certiorari in this case to clarify that payments made to obtain releases of potential tort claims, to induce employees to leave their jobs, or for other noncompensatory purposes, are not "wages" within the meaning of I.R.C. § 3121(a).

B. The Court of Appeals' I.R.C. § 104(a)(2) Ruling Misapplies This Court's Decision in *Commissioner v. Schleier*, 515 U.S. 323 (1995), Is Inconsistent With Longstanding I.R.C. § 104(a)(2) Case Law, and Will Affect Many Cases Involving Settlements of Contested Claims.

In 1994, in *Commissioner v. Schleier*, 515 U.S. 323 (1995), this Court held that I.R.C. § 104(a)(2) does not apply to back pay and liquidated damages awarded under the Age Discrimination in Employment Act of 1976 ("ADEA"). The Court held that both types of ADEA damages "are not received 'on account of personal injury or sickness,'" 515

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[12] Such programs are frequent and are widely reported. For example, on December 13, 2000, General Motors Corp. announced that it would eliminate 6,000 jobs in North America through early retirements and other incentives ("GM Plans Deep Cuts in U.S. and Overseas," *Wall Street Journal*, December 13, 2000); on January 25, 1999, AT&T Corporation announced that 20,000 of its employees had accepted early retirement offers ("AT&T Posts 58 Percent Profit Rise," *Associated Press*, January 25, 1999); on October 13, 1998, Bell Atlantic Corp. announced that 5,200 employees had accepted early retirement offers ("Bell Atlantic Expects Profit Hit," *Associated Press*, October 13, 1998); on September 5, 1998, Ford Motor Company announced that it would offer early-retirement payments to 2,000 employees ("Ford Starts Job-Rating Buyouts Next Week," *Detroit Free Press*, September 5, 1998, at 1A).

U.S. at 332, and, accordingly, no portion of an ADEA award is excludable from gross income. 515 U.S. at 327. One basis for this holding was that, under the ADEA, awards of back pay and liquidated damages are both inherently independent of the existence or extent of any personal injury. 515 U.S. at 330-31.[13]

The Court illustrated this point by contrasting an ADEA recovery with a recovery of lost wages by the victim of an automobile accident. *See* 515 U.S. at 329-30. An accident victim is able to recover lost wages *only because* the loss of wages is one of the consequences of an accident victim's personal injury. An ADEA claimant, however, may recover both back pay and liquidated damages without even alleging that any personal injury resulted from the claimed discrimination. Hence, lost wages recovered by an accident victim are "received on account of personal injuries," while damages recovered by an ADEA claimant are not.

The *Schleier* Court did *not* hold that damages received by an accident victim are excludable only if the *amount* of damages is based on the victim's particular injuries. That is, *Schleier* neither holds nor even suggests that a payment made to settle an asserted or latent claim by an accident victim is not "received on account of personal injuries" within the meaning of I.R.C. § 104(a)(2) unless the *amount* of the payment is somehow linked to the victim's actual injuries.

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[13] *Schleier* also held that an ADEA claim is not based on "tort or tort type" rights, as required by 26 C.F.R. § 1.104-1(c). 515 U.S. at 334.

Yet this is exactly how the court of appeals below has interpreted the *Schleier* decision. The court of appeals stated:

> [T]he employees did not show that the settlement payments were received "on account of personal injuries or sickness," as required by *Schleier*. Even assuming that the employees suffered some personal injury before entering the payment agreements, no evidence of record suggests that any part of the payments was attributable to those individualized injuries. Rather than reflecting an individualized amount for each employee based on the unique individual injuries of that employee, the payments reflected an amount associated with the employee's work record.

App. 6a.[14]

The court of appeals' decision represents a fundamental departure from traditional I.R.C. § 104(a)(2) jurisprudence. It is well settled that "whether a settlement is exempt from taxation depends on the nature of the claim settled and not on the validity of the claim." *Seay v. Commissioner*, 58 T.C. 32, 37 (1972); *accord, Threlkeld v. Commissioner*, 87 T.C. 1294, 1297 (1986), *aff'd*, 848 F.2d 81 (6th Cir. 1988); *Metzger v. Commissioner*, 88 T.C. 834, 847 (1987), *aff'd*, 845 F.2d 1013 (3d Cir. 1988). Thus, for

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[14] Petitioners do not dispute that it is appropriate to take the method of computing the amount of the Payments into account in weighing all of the evidence as to IBM's principal purpose for making the Payments. However, neither the trial court nor the court of appeals determined IBM's purpose. Rather, both courts held that the Payments were not "received on account of personal injuries" irrespective of IBM's purpose for making the Payments.

example, I.R.C. § 104(a)(2) applies to the settlement of a personal injury claim where the defendant disbelieves that the claimant has suffered any injury and pays an arbitrary amount to avoid the cost of litigation. In *Stocks v. Commissioner*, 98 T.C. 1 (1992), I.R.C. § 104(a)(2) applied to a portion of a settlement payment equal to the taxpayer's annual salary. In no prior case has a court held I.R.C. § 104(a)(2) inapplicable to a payment settling a personal injury claim because of the manner in which the amount of the payment was computed.

Under the court of appeals' holding, if a delivery truck struck an automobile, and the owner of the truck offered to pay $10,000 to each occupant of the automobile for a release of his or her potential claims, without investigating the extent of his or her injuries, each $10,000 payment would be taxable even though the clear purpose of the payment was to avoid prosecution of personal injury claims.

Here, petitioners introduced substantial evidence demonstrating that (1) they had bona fide personal injury claims that they could have asserted against IBM in the absence of releases and (2) IBM made the Payments to them in exchange for releases to prevent them from asserting those claims. Neither the trial court nor the court of appeals found to the contrary. The manner in which the *amounts* of their Payments were computed should not preclude application of I.R.C. § 104(a)(2) as a matter of law.

If the decision below is allowed to stand, the application of I.R.C. § 104(a)(2) will be in doubt whenever an injured taxpayer accepts an early settlement offer made without investigation of the taxpayer's injuries. Likewise,

accident victims who accept early settlement offers will be treated less favorably by the tax laws than those who pursue their claims aggressively. Surely, this Court did not intend the *Schleier* decision to have such an effect.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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No. _____

In The

Supreme Court of the United States

DOUGLAS R. WILLOUGHBY, SUZANNE M. HILL, NATHAN J. MARCIANO, and BARBARA C. JORDAN,

Petitioners,

v.

UNITED STATES OF AMERICA

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Federal Circuit

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APPENDIX
TO DOUGLAS R. WILLOUGHBY, *ET AL.*'S
PETITION FOR A WRIT OF CERTIORARI

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APPENDICES

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UNITED STATES COURT OF APPEALS
FOR THE FEDERAL CIRCUIT

REIDAR ABRAHAMSEN and
MALFRID ABRAHAMSEN, et al.,

Plaintiffs,

and

DOUGLAS R. WILLOUGHBY, SUZANNE M. HILL,
NATHAN J. MARCIANO, and BARBARA C. JORDAN,

Plaintiffs-Appellants,

v.

UNITED STATES,

Defendant-Appellee.

No. 99-5136

DECIDED: September 28, 2000

Neil D. Kimmelfield, Ball Janik LLP, of Portland, Oregon, argued for plaintiffs-appellants. With him on the brief was James T. McDermott.

Donald B. Tobin, Attorney, Tax Division, Department of Justice, of Washington, DC, argued for defendant-appellee. With him on the brief were Loretta C. Argrett, Assistant Attorney General; and Kenneth L. Greene, Attorney.

Appealed from: United States Court of Federal Claims

Judge Nancy B. Firestone

Before PLAGER, RADER, and SCHALL, Circuit Judges.

RADER, Circuit Judge.

APPENDIX A

Reidar Abrahamsen and 2,630 other former International Business Machines Corporation (IBM) employees received lump-sum payments at the end of their employment. IBM withheld federal income tax and Federal Insurance Contribution Act (FICA) tax from these exit-incentive buyout payments. The former IBM employees sought refunds of those withheld amounts. On the Government's motion for summary judgment, the United States Court of Federal Claims concluded that the payments did not qualify for exclusion from gross income under 26 U.S.C. § 104(a)(2) (2000) and that they constituted wages subject to FICA tax under 26 U.S.C. § 3121(a) (2000). See Abrahamsen v. United States, 44 Fed. Cl. 260 (1999). Because the trial court correctly construed the tax code to permit withholding, this court affirms.

I.

All 2,631 plaintiffs were at-will employees of IBM, and participated in one of IBM's several voluntary and involuntary exit-incentive programs designed to reduce IBM's overall workforce. The trial court designated four test cases, and upon agreement of the parties, stayed the proceedings in the remaining 2,627 cases. Abrahamsen, 44 Fed. Cl. at 260. Each of the test cases is representative of one of IBM's programs. Under all of the programs, the employees agreed to resign, retire, or take a leave of absence before retiring. The employees also executed agreements releasing IBM from all claims related to their separation. An excerpted example of these form agreements follows:

> In exchange for the sums and benefits which you will receive pursuant to the terms of the [program] [you] agree to release [IBM] from all claims, demands, actions or liabilities you may have

> against IBM of whatever kind, including but not limited to those which are related to your employment with IBM or the termination of that employment. You agree that this also releases from liability IBM's agents, directors, officers, employees, representatives, successors and assigns (hereinafter "those associated with IBM") . . . You also agree that this release covers, but is not limited to, claims arising from the Age Discrimination in Employment Act of 1967, as amended, Title VII of the Civil Rights Acts of 1964, as amended, and any other federal or state law dealing with discrimination in employment on the basis of sex, race, national origin, religion, disability, or age. You also agree that this release includes claims based on theories of contract or tort, whether based on common law or otherwise. . . . IBM will withhold from your [program] payment the appropriate payroll taxes . . . . In the event of rehire by IBM or any of its subsidiaries as a regular employee, you understand that IBM reserves the right to require repayment of a prorated portion of the [program] payment.

Abrahamsen, 44 Fed. Cl. at 262 (footnote omitted). The parties stipulated that the employees did not actually negotiate with IBM to acquire these agreements.

The four test-case employees each accepted lump-sum cash payments computed based on their salary and years of service to IBM. Employees in the voluntary programs received one week's salary per six months of service, not to exceed fifty-two weeks' salary. Employees in the involuntary programs received payments under the same formula, but with a cap of twenty-six weeks' salary. None

of the employees were allowed to negotiate payments that differed from the formula. IBM also informed each employee that their payments would be subject to withholding taxes. The test-case employees stipulated that they did not experience any symptoms of personal injury, that they did not assert or threaten any claim against IBM for personal injury, and that they did not communicate with IBM regarding any personal injuries or claims for personal injury. Finally, other than the fact that the employees agreed to release all claims against IBM generally, nothing in the buyout agreements indicated that IBM considered the payments as settlement of tort or tort-like claims for personal injury or sickness.

II.

This court reviews the trial court's grant of the Government's motion for summary judgment without deference. See Southfork Sys., Inc. v. United States, 141 F.3d 1124, 1131 (Fed. Cir. 1998); Nobelpharma AB v. Implant Innovations, Inc., 141 F.3d 1059, 1064, 46 USPQ2d 1097, 1103 (Fed. Cir. 1998). Summary judgment is appropriate where the record shows no genuine issues of material fact and the movant is entitled to judgment as a matter of law. See Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 247 (1986); Lockheed Martin Corp. v. United States, 210 F.3d 1366, 1372 (Fed. Cir. 2000). The Federal Rules of Civil Procedure require courts considering summary judgment to draw all reasonable inferences in favor of the non-movant. See Anderson, 477 U.S. at 255.

The employees seek a refund for two reasons. First, the employees consider IBM's exit-incentive payments as damages for tort or tort-type claims related to personal injury or sickness, which are thus excludable from income. See 26 U.S.C. § 104(a)(2). Next, the employees do not

consider these payments as "wages" or "remuneration for employment" qualifying for taxation under FICA. See 26 U.S.C. § 3121(a) and (b).

A.

The tax code provides an extraordinarily broad definition of "gross income." Section 61(a) of the Internal Revenue Code says that "gross income means all income from whatever source derived." See 26 U.S.C. § 61(a) (1994). The Supreme Court has explained that this broad definition in § 61(a) shows that Congress has exercised "the full measure of its taxing power . . . bring[ing] within the definition of income any accession to wealth." United States v. Burke, 504 U.S. 229, 233 (1992) (citations omitted). The Supreme Court has "also emphasized the corollary to § 61(a)'s broad construction, namely, the default rule of statutory interpretation that exclusions from income must be narrowly construed." Commissioner v. Schleier, 515 U.S. 323, 328 (1995) (quoting Burke, 504 U.S. at 248 (Souter, J., concurring)) (quotations omitted). The employees, as the party claiming a tax exemption, bear the burden of establishing their entitlement to an exemption based on a specific provision of the tax code. See The Bubble Room, Inc. v. United States, 159 F.3d 553, 561 (Fed. Cir. 1998) (citing United States v. Janis, 428 U.S. 433, 440-41 (1976)).

The employees seek to fit within the narrow exclusion of § 104(a)(2). Under that exclusion, "gross income does not include -- . . . (2) the amount of any damages (other than punitive damages) received (whether by suit or agreement and whether as lump sums or as periodic payments) on account of personal injuries or physical sickness." 26 U.S.C. § 104(a)(2). "The term 'damages received (whether by suit or agreement)' means an amount received . . . through prosecution of a legal suit or action based upon tort or tort

type rights, or through a settlement agreement entered into in lieu of such prosecution." 26 C.F.R. § 1.104-1(c) (1991). The Supreme Court in Burke provided some guidance as to the proper construction of the § 104(a)(2) exclusion: "IRS regulations formally have linked identification of a personal injury for purposes of § 104(a)(2) to traditional tort principles." Burke, 504 U.S. at 234.

In Schleier, the Supreme Court clarified that two independent tests must be met for a settlement amount to be excluded from gross income under § 104(a)(2). See Schleier, 515 U.S. at 337. Specifically, a taxpayer must show that: (1) the underlying cause of action giving rise to the recovery was "based upon tort or tort type rights"; and (2) the damages were received "on account of personal injuries or [physical] sickness." Id.

This court agrees with the trial court's conclusion that the employees did not show that the settlement payments were received "on account of personal injuries or sickness," as required under Schleier. Even assuming that the employees suffered some personal injury before entering the payment agreements, no evidence of record suggests that any part of the payments was attributable to those individualized injuries. As found by the trial court, the payments were calculated based on each employee's salary and years of service to IBM. Rather than reflecting an individualized amount for each employee based on the unique individual injuries of that employee, the payments reflected an amount associated with the employee's work record. Abrahamsen, 44 Fed. Cl. at 270-71. Thus, as in Schleier, the amount of payment was "completely independent of the existence or extent of any personal injury." 515 U.S. at 330.

Because the employees have not shown that the payments at issue were made on account of any personal injury, they have not satisfied the second Schleier test. See Pipitone v. United States, 180 F.3d 859, 865 (7th Cir. 1999) ("[T]he record is devoid of any evidence demonstrating what, if any, portion of the payments made to Pipitone was allocable to his alleged claims of tort or tort-type damages for personal injuries and sickness."). This court therefore affirms the Court of Federal Claims' holding that § 104(a)(2) does not operate to exclude these payments from the employees' gross income.

B.

This court next considers whether IBM's exit-incentive payments are "wages" based on "remuneration for employment" as defined under FICA. See 26 U.S.C. § 3121(a) and (b). FICA taxes, which fund Social Security programs, are calculated as a percentage of an employee's wages. The term "wages" encompasses "all remuneration for employment" unless specifically excepted. 26 U.S.C. § 3121(a). "Employment," in turn, means "any service, of whatever nature, performed . . . by an employee for the person employing him." 26 U.S.C. § 3121(b).

The Supreme Court interprets the phrase "remuneration for employment" as it appears in § 3121 broadly. See Social Sec. Bd. v. Nierotko, 327 U.S. 358, 365 (1946) ("The very words 'any service . . . performed . . . for his employer,' with the purpose of the Social Security Act in mind, import breadth of coverage."). Specifically, the Supreme Court in Nierotko concluded that "service" in the phrase "any service performed" means not only work actually performed, but also the entire employer-employee relationship for which compensation is paid to the employee by the employer. See id. at 365-66. Under this

interpretation, for instance, the Court concluded that "back pay" granted under the National Labor Relations Act to a wrongfully discharged employee constituted "wages" under the Social Security Act. See id. at 364.

In a tax refund case, the taxpayer bears the burden of establishing the right to a refund. See Snap-On Tools, Inc. v. United States, 26 Cl. Ct. 1045, 1055 (1992), aff'd 26 F.3d 137 (Fed. Cir. 1994). Thus, the employees bear the burden of establishing that the payments at issue did not constitute "wages" for FICA purposes. The employees suggest that IBM made the exit-incentive payments for a purpose other than remuneration for employment, namely to prevent departing employees from suing IBM. Thus, the employees contend, the Court of Federal Claims erroneously based its holding that the payments were wages on IBM's formula for determining amounts of the payments ("severance-type"), rather than on the purpose for which the payments were made (non-compensatory). The record shows, however, that IBM also intended the payments to facilitate its efforts to downsize the company, to ease departing employees' transition into a new career or retirement, to maintain a good corporate image and employee morale, and to treat employees fairly. Thus, the record reveals that the payments were intended both to induce employees to leave and to settle any claims the employees may have had against IBM.

The definition of "wages" in 26 U.S.C. § 3121(a) and the Supreme Court's interpretation of the term in Nierotko lead us to conclude that the payments at issue here are "wages" subject to FICA taxes. If the payments at issue were merely severance payments that were not conditioned on a release of any claims, they would constitute "wages" because they would be compensation

paid to the employees by their employer for the employer-employee relationship. See Nierotko, 327 U.S. at 365-66; see also H.R. Rep. No. 81-1300 at 124, reprinted in 1950-2 C.B. 255, 277 (explaining that § 3121(a)-1 "contains no provision comparable to . . . existing law which excludes from the term 'wages' dismissal payments which the employer is not legally required to make," and stating that "[t]herefore, a dismissal payment, which is any payment made by an employer on account of involuntary separation of the employee from the service of the employer, will constitute wages"); cf. 26 C.F.R. § 31.3401(a)-1(b)(4) (providing that "[a]ny payments made by an employer to an employee on account of . . . involuntary separation . . . constitute wages" under 26 U.S.C. § 3401); Rev. Rul. 90-72, 1990-2 C.B. 211 (stating that, although there are no regulations on point, the rule set forth in 26 C.F.R. § 31.3401(a)-1(b)(4) generally applies to FICA). Nierotko squarely holds that "wages" need not be compensation for services actually rendered. See Nierotko, 327 U.S. at 365-66. Accordingly, the cases cited by the employees for the proposition that severance payments are not payments for services rendered do not undermine the conclusion that such payments are "wages" for FICA purposes.

As set forth above, the payments at issue were at least partially motivated by IBM's desire to settle any claims departing employees may have had against it. The employees, however, have failed to demonstrate that the payments were so closely related to such claims that they constituted settlement payments instead of severance payments made to compensate for the employer-employee relationship. The employees stipulated that they had not asserted or threatened any claim against IBM for personal injury, and that they had not communicated with IBM

regarding any personal injuries or claims for personal injury. Moreover, no evidence of record suggests that the employees had made any other claims against IBM, or had informed IBM of any other claims they had against it.

Furthermore, as discussed above, the agreements set the amount of the lump-sum cash payments using a formula based on the departing employee's salary and years of service to IBM, not on the nature or magnitude of any claim the employee may have been releasing. This formula further associates the payments with the employer-employee relationship, and distances them from any specific claim an employee may have had. Several circuit courts have held that payments made to "laid-off" employees to settle class action suits regarding ERISA violations were "wages" subject to FICA. See Mayberry v. United States, 151 F.3d 855, 869 (8th Cir. 1998); Hemelt v. United States, 122 F.3d, 204, 209 (4th Cir. 1997). These courts rested their decision at least in part on the fact that the payments were calculated based on the length of employment tenure and salary. See Mayberry, 151 F.3d at 860; Hemelt, 122 F.3d at 210. This court therefore concludes that the trial court in this case correctly determined that the releases did "not change the wage-like or severance-like character of the payments." Abrahamsen, 44 Fed. Cl. at 273. This court affirms the holding of the Court of Federal Claims that the payments at issue were "wages" subject to FICA taxation.

CONCLUSION

This court affirms the Court of Federal Claims' grant of summary judgment.

COSTS

Each party shall bear its own costs.

AFFIRMED.

APPENDIX A

REIDAR ABRAHAMSEN and
MALFRID ABRAHAMSEN, et al., Plaintiffs,

v.

THE UNITED STATES, Defendant.

No. 96-787T

United States Court of Federal Claims.

July 9, 1999

(Clerical corrections filed: July 15, 1999)

Neil D. Kimmelfield and *James T. McDermott,* Portland, OR, for plaintiff.

Elizabeth D. Seward, U.S. Department of Justice, Washington, D.C., with whom were *Assistant Attorney General Loretta C. Argrett* and *Chief, Court of Federal Claims Section, Mildred L. Seidman,* for defendant.

OPINION

FIRESTONE, *Judge.*

The question the court addresses on cross-motions for summary judgment is whether downsizing payments received by four former IBM employees upon signing a general release are subject to federal income and employment taxes as income and wages or are tax exempt as payments for tort-type injuries.

PROCEDURAL BACKGROUND

The instant case was brought by 2,631 former IBM employees, each of whom participated in one of four IBM downsizing programs from 1991 to 1995. They are now each claiming a refund of the federal income and Federal

Insurance Contribution Act ("FICA")[1] taxes IBM withheld from their downsizing payment. By Orders filed July 29, 1997, August 21, 1997, and September 2, 1997, the court designated four test-case plaintiffs, who are representative of the different types of IBM downsizing programs. The parties agreed to suspend the remaining 2,627 cases pending a final decision, including any appeal, of the issues that are the subject of this summary judgment.

FACTUAL BACKGROUND[2]

From 1988 through 1996, IBM designed and implemented a number of "downsizing" programs in an effort to reduce its workforce throughout the world, including the United States. Through IBM's downsizing programs in the United States, more than 60,000 employees resigned, retired, or took a leave of absence prior to retirement. Each of the four test-case plaintiffs, Douglas R. Willoughby, Suzanne M. Hill, Nathan J. Marciano, and Barbara C. Jordan, was an at-will IBM employee who left the company pursuant to one of IBM's downsizing programs.

From 1991 through 1995, IBM instituted voluntary, involuntary, and hybrid downsizing programs. Under each of IBM's downsizing programs, employees were offered lump-sum cash payments based on their salary and years in service in exchange for signing a General Release and Covenant Not to Sue (the "release"). The

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[1] 26 U.S.C. §§ 3101-3128 (1994 & Supp. 1999).

[2] The following facts are taken from the parties' Joint Stipulation of Facts and the facts asserted in the parties' summary judgment briefs. As discussed, infra, while certain inferences to be drawn from the facts are in dispute, none of these inferences are material to the ultimate outcome of this case.

release language for each program was substantially similar in form and substance and provided as follows:

In exchange for the sums and benefits which you will receive pursuant to the terms of the [program] [you] agree to release [IBM] from all claims, demands, actions or liabilities you may have against IBM of whatever kind, including but not limited to those which are related to your employment with IBM or the termination of that employment.[3] You agree that this also releases from liability IBM's agents, directors, officers, employees, representatives, successors and assigns (hereinafter "those associated with IBM"). . . . You also agree that this release covers, but is not limited to, claims arising from the Age Discrimination in Employment Act of 1967, as amended, Title VII of the Civil Rights Acts of 1964, as amended, and any other federal or state law dealing with discrimination in employment on the basis of sex, race, national origin, religion, disability, or age. *You also agree that this release includes claims based on theories of contract or tort, whether based on common law or otherwise. . . . IBM will withhold from your [program] payment the appropriate payroll taxes*[4]*. . . . In the event of rehire by IBM or any of its subsidiaries as a regular employee, you understand*

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[3] The Voluntary Transition Payment Program's ("VTP") release waived claims pertaining only to the program participant's employment with IBM or termination of that employment.

[4] Although the releases associated with the VTP and the ITO II Pre-Retirement Leave of Absence programs contained this notification that IBM would withhold appropriate taxes, the Mid-Hudson Valley Transition Program ("MHVTP") and the Resource Restructuring Transition Plan ("RRTP") did not. However, both the MHVTP and the RRTP employee information packages provided the withholding notification.

that IBM reserves the right to require repayment of a prorated portion of the [program] payment. (emphasis added)

Under the terms of the voluntary programs, departing employees received one week's salary for each six months of service, fully or partially completed, up to a maximum of fifty-two weeks of pay. Employees departing under the involuntary program received a week's salary for each six months of service up to a maximum of twenty-six weeks of salary. IBM did not negotiate the amount of the payment any program participant received. Similarly, IBM did not negotiate its standardized release form with program participants. Finally, IBM did not allocate any portion of its program payments to the settlement of any tort or tort-type claims for personal injury or sickness. Indeed, each participant was informed, either through the release or through the program documents, that their payment would be subject to withholding of appropriate federal taxes. Each employee also was informed that if they were to return to IBM they would have to return a prorated portion of their payment. It is against this backdrop that the facts concerning each of the four test case plaintiffs will be examined.

A. Douglas R. Willoughby

Mr. Willoughby began his employment with IBM in June 1959. From September 1984 to February 1991, Mr. Willoughby worked as an Advisory Engineer in IBM's Poughkeepsie, New York laboratory. On March 28, 1991, IBM announced the Voluntary Transition Payment Program ("VTP") and, soon thereafter, distributed the VTP Employee Information Package to all employees at Mr. Willoughby's site. Although Mr. Willoughby had considered retiring as early as 1986 and 1987 under previous IBM downsizing programs, he declined to leave

at that time for financial reasons. By 1991, however, Mr. Willoughby's workload had increased while his job satisfaction had decreased. After reviewing the VTP Employee Information Package, Mr. Willoughby believed his future with IBM was at best uncertain. On May 31, 1991, he applied for the "voluntary transition payment" and indicated to IBM that he would retire if his application were approved. Mr. Willoughby's receipt of his VTP payment was contingent upon his retiring by December 31, 1991, and upon his signing IBM's General Release and Covenant Not to Sue.[5] Mr. Willoughby signed the release and received a lump-sum payment of $67,148.

For the purposes of this litigation Mr. Willoughby stipulated that prior to signing the general release and covenant not to sue he had not experienced any symptoms of personal injury, including any physical or emotional harm; had not asserted or threatened any claim against IBM for personal injury, including any physical or emotional harm; and had not communicated with IBM regarding any personal injuries or claims for personal injury, including any physical or emotional harm.

IBM issued a W-2 to Mr. Willoughby for 1991 showing wages of $140,038.13, which included the $67,148 lump sum payment. On March 21, 1995, Mr. Willoughby filed claims for return of income and employment taxes of $20,533 and $775.59, respectively, asserting that IBM paid the $67,148 "in settlement of tort and tort type claims," including claims under the Age Discrimination in Employment Act of 1967, and thus the payment was

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[5] Mr. Willoughby's release was substantially similar in form and substance to the release language as reprinted, supra, in the statement of facts.

excludable from taxation under 26 U.S.C. § 104(a)(2).[6] He also argued that the payment was not 'wages' subject to FICA taxes because it did not constitute remuneration for employment. The Internal Revenue Service ("IRS") disallowed Mr. Willoughby's claims, and this suit timely followed.

B. Suzanne M. Hill

Ms. Hill joined IBM in 1966 and worked for more than twenty-three years as a marketing support representative. Ms. Hill participated in the ITO II Pre-Retirement Leave of Absence Program ("ITO II"). When she applied for the program, Ms. Hill had been under considerable stress. Her performance evaluation had been lowered from a "2" to a "3," and she feared being put on notice for unsatisfactory performance. IBM accepted Ms. Hill into the ITO II program, and on July 31, 1992, she executed the required release[7] and received a lump-sum payment of $74,904.

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[6] At the time each of the plaintiffs filed their return, section 104(a)(2) provided in pertinent part that "damages received (whether by suit or agreement and whether as lump sums or as periodic payments) on account of personal injuries or sickness" are exempt from federal income tax. 26 U.S.C. § 104(a)(2). Treasury Regulation 1.104-1(c) defines "damages received" as "an amount received (other than workmen's compensation) through prosecution of a legal suit or action based upon tort or tort type rights, or through a settlement agreement entered into in lieu of such prosecution." Treas. Reg. § 1.104-1(c) (as amended in 1970). Such payments also are excluded from FICA on the grounds that they are not "wages" under 26 U.S.C. § 3101 ("remuneration for employment").

[7] Ms. Hill's release mirrored the release language as reprinted, supra, in the statement of facts.

For the purposes of this litigation Ms. Hill stipulated that prior to signing the general release and covenant not to sue she had not experienced any symptoms of personal injury, including any physical or emotional harm, had not asserted or threatened any claim against IBM for tort-type personal injury or sickness, and had not communicated with IBM regarding any such claims.

IBM issued Ms. Hill a form W-2 for 1992 showing wages of $113,327.24, which included the $74,904 lump sum payment. On her 1992 tax return Ms. Hill reported the $74,904 payment. On July 25, 1994, Ms. Hill filed an amended tax return on which she claimed a refund of income taxes of $22,433. Ms. Hill maintained that the payment was excludable under section 104(a)(2) because it was received "in exchange for the release and/or settlement of tort type rights as part of the former employer's [downsizing] program." On June 26, 1995, Ms. Hill filed a claim for refund of Social Security taxes of $1,960.23, asserting substantially the same grounds as Mr. Willoughby. By letter dated August 21, 1995, the IRS disallowed her claims. Thereafter, Ms. Hill timely filed this suit.

C. Mr. Nathan Marciano

Mr. Marciano joined IBM in 1965 and worked for nearly twenty-eight years in various technical support positions. Mr. Marciano participated in the Mid-Hudson Valley Transition Program ("MHVTP") program. Mr. Marciano's application to the program on March 22, 1993, was due in part to his transfer to a different department, which was followed by a drop in his employee appraisal rating and an undesirable work assignment. IBM accepted Mr. Marciano's MHVTP application, and upon executing

the required release,[8] Mr. Marciano received a lump-sum payment of $56,744. For the purposes of this litigation Mr. Marciano also has stipulated that he never asserted or threatened a tort-type claim against IBM for personal injury or sickness. He further stipulated that he never communicated with IBM regarding any such claims.

IBM issued a W-2 to Mr. Marciano for 1993 showing wages of $83,409.41, which included the $56,744 lump sum payment. On his 1993 tax return Mr. Marciano included the $56,744 in wages. On May 11, 1995, Mr. Marciano filed an amended tax return, claiming a refund on income tax of $14,535. Mr. Marciano maintained that the payment was excludable under section 104(a)(2) because it was received "in settlement of his claims based on tort and tort type rights, including rights under the Age Discrimination in Employment Act of 1967." On the same date Mr. Marciano filed a claim for refund of Social Security taxes of $2,741.00, asserting the same grounds as Mr. Willoughby and Ms. Hill. On July 31, 1995, the IRS disallowed Mr. Marciano's claims, and this suit timely followed.

D. Ms. Barbara C. Jordan

Ms. Jordan joined IBM in 1984 and worked for approximately ten years as an advisory marketing representative. On January 27, 1994, Ms. Jordan's manager gave her the Resource Restructuring Transition Plan ("RRTP") summary description and notified her that she had been designated "surplus" and was to be laid off permanently effective March 31, 1994. Immediately afterwards, IBM placed her on administrative leave in

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[8] Mr. Marciano's release was substantially similar in form and substance to the release language as reprinted, supra, in the statement of facts.

order for her to find a new job or another job at IBM. Ms. Jordan was unsuccessful in finding a new job. Although Ms. Jordan consulted with more than one attorney regarding possible discrimination claims she believed she had against IBM, Ms. Jordan never filed a claim but instead decided to take the payment IBM offered under the RRTP program. On March 31, 1994, Ms. Jordan signed the release and covenant not to sue[9] and received a $27,355.55 payment.

Ms. Jordan has entered into the same stipulations as the other test-case plaintiffs. She agrees that she never experienced any symptoms of personal injury, including any physical or emotional harm, never asserted or threatened a claim for tort-type injuries, and never communicated with IBM about any tort-type claims.

IBM issued a W-2 to Ms. Jordan for 1994 showing wages of $44,896.44, which included the $25,355.55 lump sum payment. Ms. Jordan included the $27,335.55 in wages on her 1995 tax return. On July 18, 1995, Ms. Jordan filed an amended tax return, claiming a refund of income taxes of $11,764. As grounds for her claim, Ms. Jordan maintained that the payment was excludable under section 104(a)(2) because it was received "in settlement of taxpayer's claims based on tort or tort type rights, including rights under the Age Discrimination in Employment Act of 1967." On the same date she filed a claim for refund of Social Security taxes of $2,001.68, asserting the same grounds as the other test-case plaintiffs.

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[9] Ms. Jordan's release was substantially similar in form and substance to the release language as reprinted, supra, in the statement of facts.

On August 5, 1995, the IRS disallowed Ms. Jordan's claims, and this suit timely followed.

E. The Basic Purpose of IBM's Downsizing Payments

Despite their agreement on the above-noted facts, the parties are not in agreement over IBM's basic purpose in making the payments to former employees under its various downsizing programs. Over defendant's objection, plaintiffs have filed the Declarations of Richard J. Reibstein and Frank Berte.[10] Mr. Reibstein, an attorney specializing in labor and employment law, asserted that based on his examination of IBM downsizing program documents, deposition testimony, and other documents, IBM reasonably should have concluded that (1) of the entire risk of liability to which IBM was exposed from employees participating in the voluntary downsizing program, approximately 95% of the risk was attributable to tort claims, and (2) of the entire risk of liability to which it was exposed from employees participating in the involuntary downsizing programs, approximately 85% of the risk was attributable to tort claims. Plaintiffs also offer Mr. Berte's statement. Mr. Berte is a former IBM employee who left

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[10] Although defendant initially moved to strike Mr. Berte's statement on the grounds that he was not timely identified and has since died, defendant waived the objection to Mr. Berte's statement at oral argument. Defendant also has moved to strike Mr. Reibstein's statement on the grounds that Mr. Reibstein's opinion regarding allocation of the IBM downsizing payments is not relevant because IBM did not, in fact, allocate any portion of its payments to these plaintiffs for tort claims, and the opinion testimony is not based on any direct evidence of IBM's intent in making a payment to these plaintiffs. Defendant's motion in regard to Mr. Reibstein is dealt with, infra, at footnote 18.

IBM under a downsizing program and subsequently worked for a recruiting firm where he attempted to place former IBM employees in new jobs after they left IBM under its downsizing programs. Plaintiffs offer his statement to prove that former IBM employees were stigmatized and defamed by the downsizing process. Plaintiffs contend, based on Mr. Berte's statement together with the undisputed evidence listed below, that the exchange of money for a release makes the payments tax-exempt tort settlement payments. The undisputed evidence plaintiffs rely on to support their contention may be summarized as follows:

1. IBM only made lump sum payments to employees who agreed to sign releases;
2. IBM intended each release to cover that employee's potential claims;
3. IBM had serious and realistic concerns about the threat of lawsuits that could be brought, including concerns about arguably tortious acts, and the emotional suffering caused by downsizing;
4. IBM considered every employee a potential litigant;
5. IBM employees were told that their payments were "in exchange" for their releases;
6. The program documents expressly referred to the lump sum payments as "monetary settlements" or "settlements;" and
7. Because IBM employees were "at will" employees, IBM did not need to induce plaintiffs to leave.

Finally, plaintiffs contend, based on inferences drawn from Mr. Reibstein's expert opinion, that 95% of the payments IBM made under its voluntary programs should

be allocated to tort damages, and 85% of the payments IBM made under its involuntary program should be allocated to tort damages.

Defendant disagrees with plaintiffs' characterization of the evidence and contends that IBM's basic purpose in offering payments to departing employees was to encourage employees participating in the voluntary downsizing programs to leave and to ease all employees in their transition away from IBM. Defendant contends, therefore, that the basic purpose of the payments was not to obtain "releases," but to provide severance. In addition, to show that the payments were not tort settlement payments, defendant points to the following undisputed evidence:

1. The payments to plaintiffs were not individually negotiated or tied to any individual tort claims but were based on years in service and amount of salary;
2. IBM did not calculate the payment formula based upon potential tort litigation risks;
3. IBM made the payments based on the same formula it had applied before it asked for a release;
4. The release each plaintiff signed was general, was not individually negotiated, and did not identify any specific tort claims;
5. IBM was not aware of any tort claims for personal injury or sickness by these plaintiffs;
6. The plaintiffs each stipulated that they had not suffered any symptoms of physical or emotional injury before signing the release; and

7. IBM required employees to agree to return a prorated portion of the payment if they returned to IBM.

Based on these facts, defendant argues that the payments to these individual plaintiffs were severance payments and thus taxable.

F. Proceedings Below

Following extensive discovery, defendant moved for summary judgment on May 22, 1998. Plaintiffs filed a cross-motion for summary judgment on August 7, 1998. Briefing was concluded in June 1999. Oral argument was heard on June 10, 1999.

DISCUSSION

I. Summary Judgment

Summary judgment is appropriate where there is no genuine issue of material fact, and the moving party is entitled to judgment as a matter of law. See Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 247 (1986); Mingus Constructors, Inc. v. United States, 812 F.2d 1387, 1390 (Fed. Cir. 1987). When the parties have filed cross-motions for summary judgment, the court must evaluate each motion on its own merits. See Thermocor, Inc. v. United States, 35 Fed. Cl. 480, 485 (1996) (citing Prineville Sawmill Co. v. United States, 859 F.2d 905, 911 (Fed. Cir. 1988)). "The fact that both parties argue in favor of summary judgment and allege that there are no genuine issues of material fact for trial does not relieve the court of its duty to decide whether summary judgment is appropriate." Id. In deciding whether summary judgment is appropriate, it is not the court's function "to weigh the evidence and determine the truth of the matter but to determine whether

there is a genuine issue for trial." Liberty Lobby, 477 U.S. at 249.

A complete analysis of the facts and law leads the court to conclude that, despite the parties' disagreement over the basic purpose for IBM's payment, the case is appropriate for summary judgment. Summary judgment is appropriate against a party who fails to adduce facts sufficient to establish the existence of an element essential to that party's case and for which they would bear the burden at trial. See Celotex Corp. v. Catrett, 477 U.S. 317, 322-23 (1986) ("[T]he plain language of Rule 56(c) mandates the entry of summary judgment, after adequate time for discovery and upon motion, against a party who fails to make a showing sufficient to establish the existence of an element essential to that party's case, and on which that party will bear the burden of proof at trial."). Here, taking all of plaintiffs' factual assertions as true, as well as all reasonable inferences from those facts in plaintiffs' favor, plaintiffs have not adduced facts sufficient to meet certain key elements of their tax exclusion claims. In such circumstances, summary judgment must be granted for the United States.

II. IBM's Payments to the Four Test-Case Plaintiffs Are Not Excludable from Income Under Section 104(a)(2).

The analysis of plaintiffs' claims must begin with 26 U.S.C. § 61(a), which states that except as otherwise provided "gross income means all income from whatever source derived." It is well established that "income" under section 61(a) is to be given its broadest meaning and that exclusions from income are disfavored. See Commissioner v. Schleier, 515 U.S. 323, 327-28 (1995); United States v. Burke, 504 U.S. 229, 233, 248 (1992); Commissioner v.

Jacobson, 336 U.S. 28, 49 (1949). "A taxpayer claiming an exclusion from income bears the burden of proving that his claim falls within an exclusionary provision of the Code." Taggi v. United States, 35 F.3d 93, 95-96 (2d Cir. 1994). Here, plaintiffs claim that their payments are excludable from income pursuant to 26 U.S.C. § 104(a)(2).

Section 104(a)(2) excludes from income "the amount of any damages received (whether by suit or agreement and whether as lump sums or as periodic payments) on account of personal injuries or sickness."[11] 26 U.S.C. § 104(a)(2). Treasury Regulation 1.104-1(c) defines the term "damages received" as "an amount received . . . through prosecution of a legal suit or action based upon tort or tort type rights, or through a settlement agreement entered into in lieu of such prosecution." Treas. Reg. § 1.104-1(c) (as amended in 1970).

Plaintiffs concede that none of the four test-case plaintiffs prosecuted a legal suit or action based upon tort or tort-type rights. Thus, in order to qualify for exclusion under section 104(a)(2), plaintiffs must demonstrate the existence of a "settlement agreement" entered into "in lieu of such prosecution." In this connection, plaintiffs agree that "where the issue is an asserted exclusion from taxable income, it is imperative that a 'settlement agreement' involve a bona fide dispute" over excludable damages. Taggi, 35 F.3d at 95; accord Pipitone v. United States, No. 98-3624, 1999 WL 384164, at *3 (7th Cir. 1999); Gadja v.

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[11] In 1996 section 104(a)(2) was amended specifically to provide that "punitive damages" are not excludable from income under section 104(a)(2) and to change "personal injuries and sickness" to "personal physical injuries or physical sickness." Small Business Job Protection Act of 1996, Pub. L. No. 104-188, § 1605, 110 Stat. 1755, 1838.

Commissioner, 158 F.3d 802, 805 (5th Cir. 1998); Lubart v. Commissioner, 154 F.3d 539, 542 (5th Cir. 1998).

In addition, the parties agree that plaintiffs also must meet two more requirements under section 104(a)(2) as set forth in Commissioner v. Schleier, 515 U.S. 323, 337 (1995).[12] In Schleier the Supreme Court explained that in order for payments to be excludable under section 104(a)(2), "the taxpayer must [first] demonstrate that the underlying cause of action giving rise to the recovery is '*based upon tort or tort type rights*'; and second, the taxpayer must show that the damages were received '*on account of personal injuries or sickness*.'" Id. (emphasis added).

Tested against these agreed-upon standards, defendant argues that the four test-case plaintiffs in this case are no different from the plaintiffs in fifteen previous cases whose IBM downsizing payments have been found to be subject to federal income taxation.[13] As a threshold matter,

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[12] In Schleier the Supreme Court held that recovery under the Age Discrimination in Employment Act of 1967 is not excludable from gross income under section 104(a)(2). In doing so the court laid out the tests to be applied in determining whether payments are excludable under section 104(a)(2). The Court's decision in Schleier followed a 1992 Supreme Court case holding that a payment received in settlement of a backpay claim under the pre-1991 version of Title VII of the Civil Rights Act of 1964 was not excludable from gross income under section 104(a)(2). See United States v. Burke, 504 U.S. 229 (1992).

[13] The cases, all decided without trial, are: Gadja v. Commissioner, 158 F.3d 802 (5th Cir. 1998), aff'g 74 T.C.M. (CCH) 228 (1997); Lubart v. Commissioner, 154 F.3d 539 (5th Cir. 1998), aff'g 74 T.C.M. (CCH) 223 (1997); Cook v. United States, No. 97-829T (Fed. Cl. June 21, 1999); Aschkenasy v. Internal Revenue Serv., No. 96-1932, 1998 WL 438829 (S.D.N.Y. July 27, 1998); Adams v. Commissioner, 74 T.C.M. (CCH) 277 (1997);

defendant argues that the releases plaintiffs signed in exchange for payment do not constitute tort "settlements" "in lieu of litigation," as required under section 104(a)(2), because plaintiffs have stipulated that they never formally or informally asserted, threatened, or informed IBM of an individual claim against IBM for personal injury.[14] In the alternative, defendant argues that even if the releases in exchange for payments constitute a settlement of potential claims, plaintiffs cannot meet the two Schleier tests. Specifically, defendant argues that plaintiffs have failed to "demonstrate that the underlying cause of action giving rise to the recovery is 'based upon tort or tort type rights.'"

Brennan v. Commissioner, 74 T.C.M. (CCH) 69 (1997); Carey v. Commissioner, 74 T.C.M. (CCH) 705 (1997); Hamm v. Commissioner, 74 T.C.M. (CCH) 279 (1997); Harford v. Commissioner, 76 T.C.M. (CCH) 771 (1998); Keel v. Commissioner, 73 T.C.M. (CCH) 3092 (1997); Morabito v. Commissioner, 74 T.C.M. (CCH) 62 (1997); Phillips v. Commissioner, 74 T.C.M. (CCH) 187 (1997); Sodoma v. Commissioner, 71 T.C.M. (CCH) 3178 (1996), aff'd by unpublished opinion, 139 F.3d 899 (5th Cir. 1998); Thorpe v. Commissioner, 74 T.C.M. (CCH) 219 (1997); Webb v. Commissioner, 71 T.C.M. (CCH) 2004 (1996).

[14] Plaintiffs also stipulated that they had not experienced any tort-related injury symptoms before signing their releases. Plaintiffs seek to overcome the inference that they did not, therefore, have a claim, with the statement of Dr. Peter, who (without meeting any of the plaintiffs) contends that each of the plaintiffs was in fact emotionally harmed by the downsizing programs. While the court seriously questions Dr. Peter's methodology, the court will allow Dr. Peter's statement into evidence for the limited purpose of showing that downsizing programs may result in emotional stress, a fact defendant does not dispute.

APPENDIX B

Id. Defendant next argues that even if plaintiffs meet the first prong of Schleier, they cannot satisfy the second because plaintiffs presented no evidence to show that IBM paid them "on account of " any personal injury claims. Defendant argues that, as a matter of law, where, as here, a settlement agreement addresses a number of claims, and the parties do not allocate any portion of the payment for tort damages, the court must consider the entire amount taxable. See Pipitone, 1999 WL at *6; Taggi, 35 F.3d at 96.

Plaintiffs argue, in response, that the lump-sum payments they received from IBM in exchange for a release are settlement payments and that they are tax-exempt as payments for personal injury and sickness under section 104(a)(2). Relying on Agar v. Commissioner, 290 F.2d 283 (2nd Cir. 1961),[15] plaintiffs contend that to prevail they need only show that IBM's basic reason for insisting on the release was to avoid tort claims. Plaintiffs argue that they have adduced facts to show that IBM was concerned about its potential tort liability and therefore only paid those employees who agreed to waive their tort claims. Plaintiffs argue that these facts show that the payments properly may be characterized as tort settlement payments "in lieu of litigation."

Plaintiffs argue based on the same facts that they have satisfied the two prongs of the Schleier test. Under

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[15] In Agar the Second Circuit decided that the payment Agar received in settlement of his employment-related slander claim was not excludable from gross income under section 104(a)(2) on the grounds that it was in the nature of a severance payment. See Agar, 290 F.2d at 284. In deciding the case the Second Circuit stated that "the ultimate inquiry" to be applied in characterizing settlement payments "is into the 'basic reason' for the company's payment." Id.

plaintiffs' analysis, the first prong of Schleier is satisfied by showing that their release covered tort claims. According to plaintiffs, if tort claims are present, the court must allocate between the non-taxable portion of the payment attributable to tort claims and the taxable portion of the payment attributable to non-tort claims. Plaintiffs suggest that the court should base this allocation on the relative liability risks IBM faced from the two types of claims. Plaintiffs maintain that the record indicates that IBM "implicitly" determined that all, or nearly all, of its financial risk from employee claims and lawsuits, and thus the financial risk that was avoided by the release, was attributable to tort claims, rather than non-tort claims. Plaintiffs' sole evidence to support this view is derived from Mr. Reibstein, plaintiffs' expert witness, who concluded that (1) of the entire risk of liability to which IBM was exposed from employees participating in the voluntary downsizing program, approximately 95% of the risk was attributable to tort claims, and (2) of the entire risk of liability to which it was exposed from employees participating in the involuntary downsizing programs, approximately 85% of the risk was attributable to tort claims.

Plaintiffs argue that they also have met the second or "on account of" prong under Schleier. Plaintiffs contend that under the second Schleier prong, payments for tort damages are excluded from income except to the extent they represent punitive or liquidated damages, interest designed to compensate the claimant for the delay in payment, or damages that compensate the taxpayer for purely economical harms that are inherently unrelated to personal injuries. Plaintiffs maintain that no portion of the

lump-sum payment that is allocable to tort claims falls into any of these taxable categories.

While the test-case plaintiffs' arguments are creative, they have failed to prove that the payments they received from IBM are excludable from income taxation under section 104(a)(2). Viewing the facts and inferences from the facts most favorably to plaintiffs, they arguably have shown that IBM's decision to require "releases" stemmed from its concern over potential tort claims. Plaintiffs have not, however, adduced any evidence to show that the "payments" or "recovery" they received from IBM were in any way tied to that concern. For the reasons discussed below, the court concludes that proof of IBM's generalized reasons for wanting a release from its downsized employees is not sufficient to show that IBM paid these plaintiffs to settle their potential tort claims.

As a threshold matter, the court agrees with defendant that plaintiffs' exchange of releases for payment does not necessarily establish settlement agreements between plaintiffs and IBM. As defendant notes, plaintiffs do not allege, nor does the record otherwise show, that any of the plaintiffs ever made any formal or informal claim against IBM. Moreover, plaintiffs have stipulated that they never experienced any symptoms of personal injury or sickness. In such circumstances, there is no basis for any individual "settlement agreements" between plaintiffs and IBM. See Taggi, 835 F. Supp. 744, 746 (S.D.N.Y. 1993), aff'd, 35 F.3d 93 (1994); Morabito, 74 T.C.M. (CCH) at 64. While plaintiffs rely on cases to show that assertions of a claim are not necessary to show a settlement, none of these cases involved plaintiffs who had stipulated that they, in effect, did not have a claim for personal injury to assert because they were symptom free. Section 104(a)(2) requires proof

of the existence of a "bona-fide" tort claim. Because plaintiffs did not appear to have such a claim, the existence of a settlement is in doubt. See Taggi, 35 F.3d at 96; Gadja, 158 F.3d at 805; Lubart, 154 F.3d at 542; Morabito, 74 T.C.M. (CCH) at 64.

However, even if the court were to agree that the releases plaintiffs signed in exchange for payment amounted to settlement agreements with IBM, plaintiffs have not shown that the payments they received were based on any one individual's tort or tort-type claims, as required by the first prong of Schleier. The payments these plaintiffs received were based on the same salary and years of service formula as every other program participant. In such circumstances, there is no basis for the court to conclude that the payments they received, as individuals, were to settle tort claims. The first prong of Schleier is predicated on proof of an individual bona fide claim. While plaintiffs argue that they have satisfied Schleier's first prong by showing IBM's generalized concern over potential tort liability, the court does not read Schleier as allowing individuals to rely on IBM's generalized concerns over tort liability to support any one individual's tort claim.[16] See Gadja, 158 F.3d at 805 ("Under

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[16] Plaintiffs rely on Mr. Berte's statement to support their contention that the reputations of employees leaving IBM under the downsizing programs were damaged by the alleged public statements of IBM executives that IBM was using the downsizing process to weed out "deadwood" and underperformers. This is not sufficient to satisfy Schleier's first prong. These statements do not prove that IBM paid plaintiffs a portion of their salary to resolve these claims. Plaintiffs' reliance on Dr. Peter's statement that they were, in fact, emotionally damaged by the downsizing program also is misplaced. Section

[plaintiff's] argument, the mere fact that IBM foresaw lawsuits arising out of the ITO II program meant that the payment was in part a settlement of those potential future claims. This argument is contradicted by Taggi v. United States.") (citation omitted); Lubart, 154 F.3d at 542.

Finally and most importantly, however, even if plaintiffs are deemed to have satisfied the first prong of Schleier by relying on IBM's generalized concerns over tort liability, they cannot satisfy the second Schleier prong and, thus, their claims must fail. None of the evidence plaintiffs presented shows that the "recovery" they received was paid "on account of" personal injury or sickness. At the heart of plaintiffs' argument is the erroneous assumption that proof of IBM's generalized concerns about tort claims, which they contend led to IBM's insistence on tort releases, also proves that IBM paid these plaintiffs "on account of" their personal injuries. Under plaintiffs' view they have no burden to show separately that the payments they received were in any way calculated or allocated to reflect their personal injuries, on either an individual or aggregate basis. In essence, plaintiffs are arguing that under the Supreme Court decision in Schleier, the test for excludability is so broad that a general release of tort and other claims in exchange for payment mandates that the court simply allocate the portion paid "on account of" tort. In Schleier, however, the Supreme Court made plain that to sustain a claim for exclusion, a taxpayer must show not only that the underlying claim was for personal injury, but also that the amount received was "on account of personal injuries." Schleier, 515 U.S. at 333 ("The regulatory

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104(a)(2) is focused on the basis for the "recovery." Plaintiffs did not present any evidence to show that their individual payments, in any way, reflected this "damage."

requirement that the amount be received in a tort type action is not a substitute for the statutory requirement that the amount be received "on account of personal injuries or sickness"; it is an additional requirement.").

Here, plaintiffs cannot meet the second prong of Schleier on an individual basis. As noted above, plaintiffs never asserted or threatened a claim against IBM. Having failed to assert or threaten any claims as individuals in the first instance, plaintiffs have not proven that the payments to them, as individuals, were "on account of" injuries associated with any tort. The fact that IBM recognized that some of its more than 60,000 downsized employees may have had tort claims and therefore insisted on releases from all employees does not mean that IBM paid any one individual "on account of" his or her injuries arising from his or her alleged tort claim. See Gadja, 158 F.3d at 805; Lubart, 154 F.3d at 542. It is undisputed that these four test-case plaintiffs received payments based on the same salary and years of service formula and signed releases that were no different from any of the other program participants. Without evidence that the payment or release was individually tailored to reflect their individual injuries, plaintiffs' claims for a tax exclusion under section 104(a)(2) must be rejected as a matter of law.

Moreover, even if the court were to agree that plaintiffs do not have to satisfy the second Schleier test on an individual basis, plaintiffs, as a group, still cannot satisfy the "on account of" test. The uncontroverted evidence shows that IBM did not consider potential tort liability or personal injury claims in devising its payment formula.[17]

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[17] It is for this reason that plaintiffs' reliance on Knevelbaard v. Commissioner, 74 T.C.M. (CCH) 161 (1997), which involved a

First, IBM used the same salary plus tenure downsizing payment formula after insisting upon a release as it had used before it insisted upon a release. Thus, the formula was not influenced by potential tort claims. Second, IBM made plain in the release that a prorated portion of the payment would have to be returned if the employee was rehired. Tort damages are not "returnable," but payments in the nature of severance payments would be returnable. Third, IBM's uncontroverted testimony makes plain that IBM did not allocate any portion of its program payments as compensation for possible tort claims. Nor did plaintiffs contradict IBM's express testimony that it did not ever consider tort claims in establishing its payment formula. In short, plaintiffs have not presented any evidence to show that the payments were made on account of personal injuries, as mandated by Schleier.

Indeed, in light of this uncontroverted evidence, plaintiffs' contention that the court should undertake an

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class-action tort settlement, is misplaced. That case involved a settlement arising from a tort class action suit where the sole claim was for tort and the payments clearly were paid "on account of" the tort claim. See id. at 169 (noting the statement of the chief representative of the party providing the settlement payments that "the money was paid . . . 'for the value, if you will, of the emotional distress claims asserted by these individual . . . plaintiffs'"). The fact that the settlement was calculated using an agreed-upon formula does not change the fact that the payment was aimed at compensating the victims for their individual tort injuries.

In contrast to Knevelbaard, stands this case. Here there is absolutely nothing in the record before this court to suggest that IBM's downsizing payments were made based on any actual or threatened class action for tort by its downsized employees.

APPENDIX B

allocation is without any basis in law or fact.[18] As the Seventh Circuit recently stated in Pipitone v. United States:

> Finally, and perhaps most importantly, the record is devoid of any evidence demonstrating what, if any, portion of the payments made to Pipitone was allocable to his alleged claims of tort or tort-type damages for personal injuries and sickness. The failure of a party seeking to demonstrate that certain amounts are excludible from income to present such evidence results in the entire amount being presumed to be taxable.

1999 WL at *6; accord Taggi, 35 F.3d at 96; Brennan, 74 T.C.M. (CCH) at 72; Morabito, 74 T.C.M. (CCH) at 64. The

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[18] Although the court will admit Mr. Reibstein's statement, the statement does not further plaintiffs' case. Mr. Reibstein's conclusions do not provide a basis upon which the court can base an allocation of the payments. Importantly, although Mr. Reibstein assessed IBM's liability risks, he never tied the percentage risk to the amount of the payments. Mr. Reibstein's declaration that 95% of IBM's liability risk was due to possible tort liability does not prove that 95% of each payment was calculated and then paid to "settle" a possible tort claim. As a result, it does not follow that the payments should be allocated on a relative risk basis. Plaintiffs have failed to show that the payments were calculated on the basis of actual or potential personal injury claims. To the contrary, the undisputed evidence shows that payments were not tied in any way to personal injury claims, but were based instead on rate of salary and years of service. Plaintiffs cannot refute this fact. Moreover, expert opinions, like Mr. Reibstein's, that are based on theoretical speculation and unsupported assumptions, do not establish a factual dispute. See Jones v. National Distillers, 484 F. Supp. 679, 683 (S.D.N.Y. 1979) (citing Merit Motors, Inc. v. Chrysler Corp., 569 F.2d 666, 673 (D.C. Cir. 1977)).

only time courts will allocate is where there is factual evidence, obtained in discovery after filing of an action or during negotiations over tort claims, to support an allocation for tort damages. The court is not aware of any decision where another court has allocated a downsizing payment or any other employee settlement payment in which the personal injury giving rise to the tort claim was not specifically litigated or negotiated. See, e.g., Robinson v. Commissioner, 70 F.3d 34 (5th Cir. 1995) (allocation based on a jury verdict); Commissioner v. Miller, 914 F.2d 586 (4th Cir. 1990), aff'd after remand by unpublished opinion, 60 F.3d 823 (4th Cir. 1995) (allocation based on a prior jury award); Greer v. United States, No. 96-117, 1998 WL 786480 (E.D. Ky. Sept. 23, 1998) (allocation based on amount that individually negotiated termination settlement was different from the normal severance package).[19] Plaintiffs have not provided the court with any reason to depart from the reasoning of those cases.

In sum, it is clear from the undisputed facts that the payments IBM made were not tied to plaintiffs' tort claims and were not paid "on account of" any personal injuries. It is for all of these reasons that plaintiffs have failed to meet the essential elements of their case and that summary judgment for the United States is appropriate.

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[19] While the court does not necessarily agree with all of the conclusions of the Greer court, at bottom that decision rests on the belief that plaintiff had a bona fide claim and was paid more than six times the normal severance payment for that claim. See Greer, 1998 WL at *1, *5.

APPENDIX B

III. The Payments Properly Were Characterized As "Wages"

Plaintiffs also seek a refund of the FICA taxes withheld from their IBM payments. Plaintiffs base their claim for a refund on two alternative grounds. First, plaintiffs argue that to the extent the payments are excludable from income under section 104(a)(2) they are not subject to FICA. In the alternative, plaintiffs argue that even if the payments are included as income, they are not "wages" subject to FICA, because the payments were not based on "remuneration for services" as required under FICA. As the court already has decided that IBM's payments to plaintiffs properly were included as income and not excludable under section 104(a)(2), plaintiffs' first argument must fail. In addition, for the reasons set forth below, the court concludes that the payments were based on remuneration for employment and, therefore, properly were taxed as "wages" under FICA.

Section 3102(a) of the Internal Revenue Code requires every employer to deduct FICA taxes from their employees' "wages" at the time of payment. 26 U.S.C. § 3102(a). Section 3121(a) defines "wages" for purposes of FICA to mean "all remuneration for employment." Id. § 3121(a). "Employment," in turn, is defined as "any service, of whatever nature performed by an employee for the person employing him." Id. § 3121(b). The Supreme Court has made plain that the term "remuneration for employment" is not limited to payments made for work that has already been performed. The Supreme Court has construed the term "service" to mean "not only work actually done but the entire employer-employee relationship for which compensation is paid to the employee by the employer." Social Sec. Bd. v. Nierotko,

327 U.S. 358, 365-66 (1946); accord Gerbec v. United States, 164 F.3d 1015, 1026 (6th Cir. 1999) ("We hold that the phrase "remuneration for employment" includes certain compensation in the employer-employee relationship for which no actual services were performed."); Mayberry v. United States, 151 F.3d 855, 860 (8th Cir. 1998); Hemelt v. United States, 122 F.3d 204, 209 (4th Cir. 1997); Associated Elec. Coop. v. United States, 42 Fed. Cl. 867, 872, 873-74 (1999). Indeed, in 1983 Congress amended FICA to provide that all payments arising from the employer-employee relationship that are not expressly excluded in the twenty-one exceptions under section 3121(a) should be subject to FICA.[20]

Thus, the issue before the court is whether the payments at issue here are payments arising out of the entire employer-employee relationship within the meaning of Nierotko. Defendant argues that the payments are best characterized as separation or severance payments that

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[20] The Senate Report discussing these amendments states, in pertinent part:

> The social security program aims to replace the income of beneficiaries when that income is reduced on account of retirement and disability. Thus, the amount of "wages" is the measure used both to define income which should be replaced and to compute FICA tax liability. Since the social security system has objectives which are significantly different from the objectives underlying the income tax withholding rules, your Committee believes that amounts exempt from income tax withholding should not be exempt from FICA unless Congress provides an explicit FICA tax exclusion.

S. Rep. No. 98-23, at 42 (1983), reprinted in 1983-2 U.S.C.C.A.N. 143, 299.

arise from the employer-employee relationship and are therefore properly subject to FICA taxes. Since 1950 the IRS consistently has maintained that severance or separation payments are subject to FICA. See S. Rep. No. 81-1669, at 130 (1950), reprinted in 1950 U.S.C.C.A.N. 3482.

Plaintiffs argue, in response, that the payments are not severance payments and are exempt from FICA as either settlement payments or payments to induce them to leave. If the payments are construed to be settlement payments, plaintiffs argue that the payments should be excluded from FICA because payments made to secure releases of employment-related claims do not arise from the employer-employee relationship. Plaintiffs argue further that "common sense" dictates that payments to induce employees to leave do not arise from the employer-employee relationship. Either way, plaintiffs contend, the payments are not wages subject to FICA taxes. For the reasons discussed below, plaintiffs' arguments are without merit.

The court agrees with plaintiffs that the payments at issue here are not simply "severance" payments because of the release IBM required each recipient to sign. This is not to say, however, that the payments did not arise from the employer-employee relationship. The undisputed facts show that IBM calculated the payments solely on the basis of employment tenure and salary basis, which is consistent with the notion of a "wage." See Mayberry, 151 F.3d at 860; Hemelt, 122 F.3d at 210; Associated Elec., 42 Fed. Cl. at 876. Under both its voluntary and involuntary programs, IBM's payments were tied solely to these criteria, which had been the same criteria used when the programs were purely severance programs. As noted above, the release requirement did not change the amount of pay. In fact, the

release itself made plain that a prorated portion of the payment would have to be returned if the employee returned to work at IBM. This clearly indicates that the payments were considered to be a substitute for wages and that the payments were part of the employer-employee relationship.

Finally, other cases involving settlement payments to downsized workers have held that payments made to downsized employees that are based on length of service and rate of pay properly are considered "wages" subject to FICA taxes. Courts have reached this conclusion even where the payments were made to settle other claims or were made as incentive payments to encourage employees to leave. See Mayberry v. United States, 151 F.3d 855, 860 (8th Cir. 1998); Hemelt v. United States, 122 F.3d 204, 209 (4th Cir. 1997); Associated Elec. Coop. v. United States, 42 Fed. Cl. 867 (1999).[21] In each of these cases the courts have looked beyond the settlement to determine the basis upon which the payments were calculated. And where, as here, the payments were calculated on a formula based solely upon the former employees' length of service and rate of

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[21] The court recognizes that the Mayberry, Hemelt, and Associated Electric decisions arose from different facts. Despite the differences, the court finds it instructive that these cases looked to the method of calculating the payment at issue as a basis for determining whether or not the payment was a wage. Moreover, the court recognizes that the Fifth Circuit decision in Dotson v. United States, 87 F.3d 682 (5th Cir. 1996), is favorable to the plaintiffs, and holds that settlement payments based on ERISA violations are not "wages" in the downsizing process. This court believes that Mayberry and Hemelt, which involve payments under the same class action settlement as Dotson, represent the better view.

pay, the payments have been deemed wages and subject to FICA taxes.[22] See Mayberry, 151 F.3d at 860; Hemelt, 122 F.3d at 210; Associated Elec., 42 Fed. Cl. at 876; see also Lane Processing Trust v. United States, 25 F.3d 662, 666 (8th Cir. 1994) (basing determination that proceeds from sale of company distributed to former employees were "wages" on the fact that the distributions were "linked to location, prior wages, length of service, and other factors traditionally used to determine employee compensation").

This court sees no reason to depart from these precedents. In this court's view, the fact that plaintiffs were required to give up certain claims to obtain the program payments does not change the wage-like or severance-like character of the payments. Whether these payments are settlement payments or were paid to entice employees to leave is not determinative because the payments at issue clearly were derived from a severance-type formula based on the employee-employer relationship. Thus, the payments were properly held to constitute wages subject to FICA under 26 U.S.C. § 3121(a).[23]

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[22] Plaintiffs argue that dicta in the Supreme Court's Lockheed Corp. v. Spink, 517 U.S. 882 (1996), decision and the Fourth Circuit's Waterman v. Commissioner, No. 98-2053, 1999 WL 357185 (4th Cir. June 3, 1999), decision compel a different result. Lockheed involved the question of whether a company's early retirement programs were prohibited transactions under ERISA. Waterman considered whether or not a payment to an enlisted member of the Navy was excludable from income under 26 U.S.C. § 112(a), as compensation for "active service." Both Lockheed and Waterman concerned different tax provisions than the one at issue here and therefore are not controlling.

[23] Plaintiffs also rely on IBM's refund action for the employer portion of these taxes to support their contention that the

CONCLUSION

For the reason set forth above, the cross-motion for summary judgment of the United States is GRANTED. Plaintiffs' cross-motion for summary judgment is DENIED. There being no just reason for delay, the clerk of the court shall enter judgment under Rule 54(b) for the United States as to Douglas R. Willoughby, Suzanne M. Hill, Nathan J. Marciano, and Barbara C. Jordan. Each party to bear its own costs.

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payments were not wages. This reliance is misplaced. IBM expressly has stated that it filed its action as a "protective" action in the event the court were to decide the payments were not wages.

I.R.C. § 104, as in effect in 1991-94 (excerpts)

(a) IN GENERAL.—Except in the case of amounts attributable to (and not in excess of) deductions allowed under section 213 (relating to medical, etc., expenses) for any prior taxable year, gross income does not include—

* * *

(2) the amount of any damages received (whether by suit or agreement and whether as lump sums or as periodic payments) on account of personal injuries or sickness; * * * *

I.R.C. § 3101 (excerpts)

(a) OLD-AGE, SURVIVORS, AND DISABILITY INSURANCE.—In addition to other taxes, there is hereby imposed on the income of every individual a tax equal to the following percentages of the wages (as defined in section 3121(a)) received by him with respect to employment (as defined in section 3121(b))-- * * * *

APPENDIX D

I.R.C. § 3121 (excerpts)

(a) WAGES.—For purposes of this chapter, the term "wages" means all remuneration for employment, including the cash value of all remuneration (including benefits) paid in any medium other than cash; * * * *

APPENDIX E